

Federal Deposit Insurance Corporation

Bank Insurance Fund Statements of Financial Position

Dollars in Thousands

	December 31, 1998	December 31, 1997
Assets		
Cash and cash equivalents	\$ 2,117,644	\$ 219,207
Investment in U.S. Treasury obligations, net (Note 3) <i>(Market value of investments at December 31, 1998 and December 31, 1997 was \$27.5 billion and \$27.1 billion, respectively)</i>	26,125,695	26,598,825
Interest receivable on investments and other assets, net	690,586	472,818
Receivables from bank resolutions, net (Note 4)	747,948	1,109,035
Assets acquired from assisted banks and terminated receiverships, net (Note 5)	27,373	60,724
Property and equipment, net (Note 6)	209,615	145,061
Total Assets	\$ 29,918,861	\$ 28,605,670
Liabilities		
Accounts payable and other liabilities	\$ 229,984	\$ 228,955
<i>Estimated liabilities for: (Note 7)</i>		
Anticipated failure of insured institutions	32,000	11,000
Assistance agreements	15,125	31,952
Litigation losses	22,301	13,500
Asset securitization guarantees	7,141	27,715
Total Liabilities	306,551	313,122
<i>Commitments and off-balance-sheet exposure (Note 12)</i>		
Fund Balance		
Accumulated net income	29,601,395	28,292,672
Unrealized gain/(loss) on available-for-sale securities, net (Note 3)	10,915	(124)
Total Fund Balance	29,612,310	28,292,548
Total Liabilities and Fund Balance	\$ 29,918,861	\$ 28,605,670

The accompanying notes are an integral part of these financial statements.

Federal Deposit Insurance Corporation

Bank Insurance Fund Statements of Income and Fund Balance

Dollars in Thousands

	For the Year Ended December 31, 1998	For the Year Ended December 31, 1997
Revenue		
Interest on U.S. Treasury obligations	\$ 1,674,344	\$ 1,519,276
Interest on advances and subrogated claims	67,350	22,073
Gain on conversion of benefit plan (Note 11)	200,532	0
Revenue from assets acquired from assisted banks and terminated receiverships	20,926	38,000
Assessments (Note 8)	21,688	24,711
Other revenue	15,422	11,558
Total Revenue	2,000,262	1,615,618
Expenses and Losses		
Operating expenses	697,604	605,214
Provision for insurance losses (Note 9)	(37,699)	(495,296)
Expenses for assets acquired from assisted banks and terminated receiverships	29,803	65,901
Interest and other insurance expenses	1,831	1,506
Total Expenses and Losses	691,539	177,325
Net Income	1,308,723	1,438,293
Unrealized gain/(loss) on available-for-sale securities, net (Note 3)	11,039	(124)
Comprehensive Income	1,319,762	1,438,169
Fund Balance - Beginning	28,292,548	26,854,379
Fund Balance - Ending	\$ 29,612,310	\$ 28,292,548

The accompanying notes are an integral part of these financial statements.

Federal Deposit Insurance Corporation

Bank Insurance Fund Statements of Cash Flows

Dollars in Thousands

	For the Year Ended December 31, 1998	For the Year Ended December 31, 1997
Cash Flows From Operating Activities		
Cash provided from:		
Interest on U.S. Treasury obligations	\$ 1,788,937	\$ 1,480,060
Recoveries from bank resolutions	881,802	3,826,273
Recoveries from assets acquired from assisted banks and terminated receiverships	54,207	141,765
Assessments	22,931	22,201
Miscellaneous receipts	27,990	24,951
Cash used for:		
Operating expenses	(711,020)	(580,515)
Disbursements for bank resolutions	(420,691)	(298,943)
Disbursements for assets acquired from assisted banks and terminated receiverships	(37,391)	(67,231)
Miscellaneous disbursements	(7,959)	(11,771)
Net Cash Provided by Operating Activities (Note 14)	1,598,806	4,536,790
Cash Flows From Investing Activities		
Cash provided from:		
Maturity and sale of U.S. Treasury obligations, held-to-maturity	5,850,000	6,300,000
Maturity and sale of U.S. Treasury obligations, available-for-sale	185,456	0
Cash used for:		
Purchase of property and equipment	(51,058)	0
Purchase of U.S. Treasury obligations, held-to-maturity	(4,478,337)	(10,373,695)
Purchase of U.S. Treasury obligations, available-for-sale	(1,206,430)	(502,020)
Net Cash Provided From (Used by) Investing Activities	299,631	(4,575,715)
Net Increase (Decrease) in Cash and Cash Equivalents	1,898,437	(38,925)
Cash and Cash Equivalents - Beginning	219,207	258,132
Cash and Cash Equivalents - Ending	\$ 2,117,644	\$ 219,207

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

Bank Insurance Fund

December 31, 1998 and 1997

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1. Legislative History and Operations of the Bank Insurance Fund

Legislative History

The U.S. Congress created the Federal Deposit Insurance Corporation (FDIC) through enactment of the Banking Act of 1933. The FDIC was created to restore and maintain public confidence in the nation's banking system.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was enacted to reform, recapitalize, and consolidate the federal deposit insurance system. The FIRREA created the Bank Insurance Fund (BIF), the Savings Association Insurance Fund (SAIF), and the FSLIC Resolution Fund (FRF). It also designated the FDIC as the administrator of these funds. All three funds are maintained separately to carry out their respective mandates.

The BIF and the SAIF are insurance funds responsible for protecting insured depositors in operating banks and thrift institutions from loss due to institution failures. The FRF is a resolution fund responsible for winding up the affairs of the former Federal Savings and Loan Insurance Corporation (FSLIC) and liquidating the assets and liabilities transferred from the former Resolution Trust Corporation (RTC).

Pursuant to FIRREA, an active institution's insurance fund membership and primary federal supervisor are generally determined by the institution's charter type. Deposits of BIF-member institutions are generally insured by the BIF; BIF members are predominantly commercial and savings banks supervised by the FDIC, the Office of the Comptroller of the Currency, or the Federal Reserve. Deposits of SAIF-member institutions are generally insured by the SAIF; SAIF members are predominantly thrifts supervised by the Office of Thrift Supervision.

In addition to traditional banks and thrifts, several other categories of institutions exist. The Federal Deposit Insurance Act (FDI Act), Section 5(d)(3), provides that a member of one insurance fund may, with the approval of its primary federal supervisor, merge, consolidate with, or acquire the deposit liabilities of an institution that is a member of the other insurance fund without changing insurance fund status for the acquired deposits. These institutions with deposits insured by both insurance funds are referred to as "Oakars" or Oakar banks. The FDI Act, Section 5(d)(2)(G), allows SAIF-member thrifts to convert to a bank charter and retain their SAIF membership. These institutions are referred to as "Sassers." The Home Owners' Loan Act (HOLA), Section 5(o), allows BIF-member banks to convert to a thrift charter and retain their BIF membership. These institutions are referred to as "HOLAs" or HOLA thrifts.

Other Significant Legislation

The Competitive Equality Banking Act of 1987 established the Financing Corporation (FICO) as a mixed-ownership government corporation whose sole purpose was to function as a financing vehicle for the FSLIC.

The Omnibus Budget Reconciliation Act of 1990 (1990 OBR Act) and the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) made changes to the FDIC's assessment authority (see Note 8) and borrowing authority. The FDICIA also requires the FDIC to: 1) resolve troubled institutions in a manner that will result in the least possible cost to the deposit insurance funds and 2) maintain the insurance funds at 1.25 percent of insured deposits or a higher percentage as circumstances warrant.

The Deposit Insurance Funds Act of 1996 (DIFA) was enacted to provide for: 1) the capitalization of the SAIF to its designated reserve ratio (DRR) of 1.25 percent by means of a one-time special assessment on SAIF-insured deposits; 2) the expansion of the assessment base for payments of the interest on obligations issued by the FICO to include all FDIC-insured banks and thrifts; 3) beginning January 1, 1997, the imposition of a FICO assessment rate on BIF-assessable deposits that is one-fifth of the rate for SAIF-assessable deposits through the earlier of December 31, 1999, or the date on which the last savings association ceases to exist; 4) the payment of the annual FICO interest obligation of approximately \$790 million on a pro rata basis between banks and thrifts on the earlier of January 1, 2000, or the date on which the last savings association ceases to exist; 5) authorization of BIF assessments only if needed to maintain the fund at the DRR; 6) the refund of amounts in the BIF in excess of the DRR with such refund not to exceed the previous semiannual assessment; and 7) the merger of the BIF and the SAIF on January 1, 1999, if no insured depository institution is a savings association on that date. Subsequently, Congress did not enact legislation during 1998 to either merge the BIF and the SAIF or to eliminate the thrift charter.

Recent Legislative Initiatives

Congress continues to focus on legislative proposals to achieve modernization of the financial services industry. Some of these proposals, if enacted into law, may have a significant impact on the BIF and/or the SAIF. However, these proposals continue to vary and FDIC management cannot predict which provisions, if any, will ultimately be enacted.

Operations of the BIF

The primary purpose of the BIF is to: 1) insure the deposits and protect the depositors of BIF-insured banks and 2) resolve failed banks, including managing and liquidating their assets. In addition, the FDIC, acting on behalf of the BIF, examines state-chartered banks that are not members of the Federal Reserve System. The FDIC also provides assistance to troubled banks and monitors compliance with the assistance agreements.

The BIF is primarily funded from the following sources: 1) interest earned on investments in U.S. Treasury obligations and 2) BIF assessment premiums.

Additional funding sources are U.S. Treasury and Federal Financing Bank (FFB) borrowings, if necessary. The 1990 OBR Act established

the FDIC's authority to borrow working capital from the FFB on behalf of the BIF and the SAIF. The FDICIA increased the FDIC's authority to borrow for insurance losses from the U.S. Treasury, on behalf of the BIF and the SAIF, from \$5 billion to \$30 billion. The FDICIA also established a limitation on obligations that can be incurred by the BIF, known as the maximum obligation limitation (MOL). At December 31, 1998, the MOL for the BIF was \$51.7 billion.

The VA, HUD and Independent Agencies Appropriations Acts of 1999 and 1998 appropriated \$34.7 million for fiscal year 1999 (October 1, 1998, through September 30, 1999) and \$34 million for fiscal year 1998 (October 1, 1997, through September 30, 1998), respectively, for operating expenses incurred by the Office of Inspector General (OIG). These Acts mandate that the funds are to be derived from the BIF, the SAIF, and the FRF.

2. Summary of Significant Accounting Policies

General

These financial statements pertain to the financial position, results of operations, and cash flows of the BIF and are presented in accordance with generally accepted accounting principles (GAAP). These statements do not include reporting for assets and liabilities of closed banks for which the FDIC acts as receiver or liquidating agent. Periodic and final accountability reports of the FDIC's activities as receiver or liquidating agent are furnished to courts, supervisory authorities, and others as required.

Use of Estimates

FDIC management makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Where it is reasonably possible that changes in estimates will cause a material change in the financial statements in the near term, the nature and extent of such changes in estimates have been disclosed.

Cash Equivalents

Cash equivalents are short-term, highly liquid investments with original maturities of three months or less. Cash equivalents primarily consist of Special U.S. Treasury Certificates.

Investments in U.S. Treasury Obligations

Investments in U.S. Treasury obligations are recorded pursuant to the provisions of the Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." SFAS No. 115 requires that securities be classified in one of three categories: held-to-maturity, available-for-sale, or trading. Securities designated as held-to-maturity are intended to be held to maturity and are shown at amortized cost. Amortized cost is the face value of securities plus the unamortized premium or less the unamortized discount. Amortizations are computed on a daily basis from the date of acquisition to the date of maturity. Beginning in 1997, the BIF designated a portion of its securities as available-for-sale. These securities are shown at fair value with unrealized gains and losses included in the fund balance. Realized gains and losses are included in other revenue when applicable. Interest on both types of securities is calculated on a daily basis and recorded monthly using the effective interest method. The BIF does not have any securities classified as trading.

Allowance for Losses on Receivables From Bank Resolutions and Assets Acquired From Assisted Banks and Terminated Receiverships

The BIF records a receivable for the amounts advanced and/or obligations incurred for resolving troubled and failed banks. The BIF also records as an asset the amounts paid for assets acquired from assisted banks and terminated receiverships. Any related allowance for loss represents the difference between the funds advanced and/or obligations incurred and the expected repayment. The latter is based on estimates of discounted cash recoveries from the assets of assisted or failed banks, net of all estimated liquidation costs.

Receivership Operations

The FDIC is responsible for managing and disposing of the assets of failed institutions in an orderly and efficient manner. The assets, and the claims against them, are accounted for separately to ensure that liquidation proceeds are distributed in accordance with applicable laws and regulations. Also, the income and expenses attributable to receiverships are accounted for as transactions of those receiverships. Liquidation expenses incurred by the BIF on behalf of the receiverships are recovered from those receiverships.

Cost Allocations Among Funds

Operating expenses not directly charged to the funds are allocated to all funds administered by the FDIC. Workload-based-allocation percentages are developed during the annual corporate planning process and through supplemental functional analyses.

Postretirement Benefits Other Than Pensions

The FDIC established an entity to provide the accounting and administration of postretirement benefits on behalf of the BIF, the SAIF, and the FRF. Each fund pays its liabilities for these benefits directly to the entity. The BIF's unfunded net postretirement benefits liability for the plan is presented in the BIF's Statements of Financial Position.

Disclosure About Recent Accounting Standard Pronouncements

In February 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 132, "Employers' Disclosures about Pension and Other Postretirement Benefits." The Statement standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable. Although changes in the BIF's disclosures for postretirement benefits have been made, the impact is not material.

In June 1998, the FASB also issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The Statement requires that all derivatives be recognized either as assets or liabilities in the statements of financial position and to measure those instruments at fair value. Based upon analysis, derivative instruments of the BIF are immaterial to the financial statements.

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This Statement requires the development or purchase cost of internal-use software to be treated as a capital asset. The FDIC adopted this Statement effective January 1, 1998. This asset is presented in the "Property and equipment, net" line item in the BIF's Statements of Financial Position (see Note 6).

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." The FDIC adopted SFAS No. 130 effective on January 1, 1997. Comprehensive income includes net income as well as certain types of unrealized gain or loss. The only component of SFAS No. 130 that impacts the BIF is unrealized gain or loss on securities classified as available-for-sale, which is presented in the BIF's Statements of Financial Position and the Statements of Income and Fund Balance.

Other recent pronouncements are not applicable to the financial statements.

Depreciation

The FDIC has designated the BIF as administrator of property and equipment used in its operations. Consequently, the BIF includes the cost of these assets in its financial statements and provides the necessary funding for them. The BIF charges the other funds rental and service fees representing an allocated share of its annual depreciation expense.

Prior to January 1, 1998, only buildings owned by the Corporation were depreciated. On January 1, 1998, FDIC began capitalizing the development and purchase cost of internal-use software in accordance with the requirements of SOP 98-1. The FDIC also began to capitalize the cost of furniture, fixtures, and general equipment. These costs were expensed in prior years on the basis that the costs were immaterial. The expanded capitalization policy had no material impact on the financial position or operation of the BIF.

The Washington, D.C. office buildings and the L. William Seidman Center in Arlington, Virginia, are depreciated on a straight-line basis over a 50-year estimated life. The San Francisco condominium offices are depreciated on a straight-line basis over a 35-year estimated life. Leasehold improvements will be capitalized and depreciated over the lesser of the remaining life of the lease or the estimated useful life of the improvements, if determined to be material. Capital assets depreciated on a straight-line basis over a five-year estimated life include mainframe equipment; furniture, fixtures and general equipment; and internal-use software. Personal computer equipment is depreciated on a straight-line basis over a three-year estimated life.

Related Parties

The nature of related parties and a description of related party transactions are disclosed throughout the financial statements and footnotes.

Reclassifications

Reclassifications have been made in the 1997 financial statements to conform to the presentation used in 1998.

3. Investment in U.S. Treasury Obligations, Net

Cash received by the BIF is invested in U.S. Treasury obligations with maturities exceeding three months unless cash is needed to meet the liquidity needs of the fund. The BIF's current portfolio includes securities classified as held-to-maturity and available-for-sale. The BIF also invests in Special U.S. Treasury Certificates that are included in the "Cash and cash equivalents" line item.

For 1998, the gross realized gain on securities classified as available-for-sale was \$224 thousand. The gain is included in the "Other revenue" line item. Proceeds from the sale were \$186 million. The cost of the securities sold was determined on a specific identification basis. There were no sales in 1997.

U.S. Treasury Obligations at December 31, 1998

Dollars in Thousands

Maturity	Yield at Purchase	Face Value	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Market Value
Held-to-Maturity						
Less than one year	5.57%	\$ 2,120,000	\$ 2,133,448	\$ 10,597	\$ 0	\$ 2,144,045
1-3 years	6.04%	5,525,000	5,564,524	148,112	0	5,712,636
3-5 years	6.19%	5,965,000	6,345,044	322,126	0	6,667,170
5-10 years	6.01%	10,295,000	10,566,047	864,116	0	11,430,163
Total		\$ 23,905,000	\$ 24,609,063	\$ 1,344,951	\$ 0	\$ 25,954,014
Available-for-Sale						
Less than one year	5.09%	\$ 940,000	\$ 946,726	\$ 4,947	\$ 0	\$ 951,673
1-3 years	5.63%	550,000	558,991	5,968	0	564,959
Total		\$ 1,490,000	\$ 1,505,717	\$ 10,915	\$ 0	\$ 1,516,632
Total Investment in U.S. Treasury Obligations, Net						
Total		\$ 25,395,000	\$ 26,114,780	\$ 1,355,866	\$ 0	\$ 27,470,646

U.S. Treasury Obligations at December 31, 1997

Dollars in Thousands

Maturity	Yield at Purchase	Face Value	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Market Value
Held-to-Maturity						
Less than one year	5.58%	\$ 5,250,000	\$ 5,240,657	\$ 5,369	\$ (5,650)	\$ 5,240,375
1-3 years	5.83%	5,280,000	5,330,281	26,113	(7,413)	5,348,983
3-5 years	6.15%	5,490,000	5,685,279	89,744	(6,895)	5,768,128
5-10 years	6.57%	9,500,000	9,840,712	439,733	0	10,280,445
Total		\$ 25,520,000	\$ 26,096,929	\$ 560,959	\$ (19,958)	\$ 26,637,931
Available-for-Sale						
1-3 years	5.67%	\$ 490,000	\$ 502,020	\$ 19	\$ (143)	\$ 501,896
Total Investment in U.S. Treasury Obligations, Net						
Total		\$ 26,010,000	\$ 26,598,949	\$ 560,978	\$ (20,101)	\$ 27,139,827

In 1998, the unamortized premium, net of unamortized discount, was \$720 million. In 1997, the unamortized premium, net of the unamortized discount, was \$589 million.

4. Receivables From Bank Resolutions, Net

The bank resolution process takes different forms depending on the unique facts and circumstances surrounding each failing or failed institution. Payments for institutions that fail are made to cover obligations to insured depositors and represent claims by the BIF against the receiverships' assets. There were three bank failures in 1998 and one in 1997, with assets of \$370 and \$26 million, respectively.

As of December 31, 1998 and 1997, the FDIC, in its receivership capacity for BIF-insured institutions, held assets with a book value of \$1.6 billion and \$2.5 billion, respectively (including cash and miscellaneous receivables of \$480 million and \$1 billion at

December 31, 1998 and 1997, respectively). These assets represent a significant source of repayment of the BIF's receivables from bank resolutions. The estimated cash recoveries from the management and disposition of these assets that are used to derive the allowance for losses are based in part on a statistical sampling of receivership assets. The sample was constructed to produce a statistically valid result. These estimated recoveries are regularly evaluated, but remain subject to uncertainties because of potential changes in economic conditions. These factors could cause the BIF's and other claimants' actual recoveries to vary from the level currently estimated.

Receivables From Bank Resolutions, Net

Dollars in Thousands

	December 31, 1998	December 31, 1997
Assets from open bank assistance	\$ 112,045	\$ 140,035
Allowance for losses	(10,727)	(38,497)
Net Assets From Open Bank Assistance	101,318	101,538
Receivables from closed banks	18,656,746	23,268,950
Allowance for losses	(18,010,116)	(22,261,453)
Net Receivables From Closed Banks	646,630	1,007,497
Total	\$ 747,948	\$ 1,109,035

5. Assets Acquired From Assisted Banks and Terminated Receiverships, Net

The BIF has acquired assets from certain troubled and failed banks by either purchasing an institution's assets outright or purchasing the assets under the terms specified in each resolution agreement. In addition, the BIF can purchase assets remaining in a receivership to facilitate termination. The methodology to estimate cash recoveries from these assets, which are used to derive the related allowance for losses, is the same as that for receivables from bank resolutions (see Note 4).

The BIF recognizes revenue and expenses on these acquired assets. Revenue consists primarily of interest earned on performing mortgages and commercial loans. Expenses are recognized for the management and liquidation of these assets.

Assets Acquired From Assisted Banks and Terminated Receiverships, Net

Dollars in Thousands

	December 31, 1998	December 31, 1997
Assets acquired from assisted banks and terminated receiverships	\$ 169,712	\$ 256,237
Allowance for losses	(142,339)	(195,513)
Total	\$ 27,373	\$ 60,724

6. Property and Equipment, Net

Property and Equipment, Net

Dollars in Thousands

	December 31, 1998	December 31, 1997
Land	\$ 29,631	\$ 29,631
Buildings	152,078	151,443
PC/LAN/WAN equipment	15,612	0
Application software	1,892	0
Mainframe equipment	354	0
Furniture, fixtures, and general equipment	764	0
Telephone equipment	460	0
Work in Progress - Application Software	49,630	0
Accumulated depreciation	(40,806)	(36,013)
Total	\$ 209,615	\$ 145,061

7. Estimated Liabilities for:

Anticipated Failure of Insured Institutions

The BIF records an estimated liability and a loss provision for banks (including Oakar and Sasser financial institutions) that are likely to fail, absent some favorable event such as obtaining additional capital or merging, when the liability becomes probable and reasonably estimable.

The estimated liabilities for anticipated failure of insured institutions as of December 31, 1998 and 1997, were \$32 million and \$11 million, respectively. The estimated liability is derived in part from estimates of recoveries from the management and disposition of the assets of these probable bank failures. Therefore, they are subject to the same uncertainties as those affecting the BIF's receivables from bank resolutions (see Note 4). This could affect the ultimate costs to the BIF from probable failures.

There are other banks where the risk of failure is less certain, but still considered reasonably possible. Should these banks fail, the BIF could incur additional estimated losses of about \$204 million.

The accuracy of these estimates will largely depend on future economic conditions. The FDIC's Board of Directors (Board) has the statutory authority to consider the estimated liability from anticipated failures of insured institutions when setting assessment rates.

Year 2000 Anticipated Failures

The BIF is also subject to a potential loss from banks that may fail if they are unable to become Year 2000 compliant in a timely manner. In May 1997, the federal financial institution regulatory agencies developed a program to conduct uniform reviews of all FDIC-insured institutions' Year 2000 readiness. The program assesses the five key phases of an institution's Year 2000 conversion efforts: 1) awareness, 2) assessment, 3) renovation, 4) validation, and 5) implementation. The reviews classify each institution as Satisfactory, Needs Improvement, or Unsatisfactory.

Satisfactory. Year 2000 efforts of financial institutions and independent data centers are considered "Satisfactory" if they exhibit acceptable performance in all key phases of the Year 2000 project management process as set forth in the May 5, 1997, Federal Financial Institutions Examination Council (FFIEC) Interagency Statement on the Year 2000 and subsequent guidance documents. Performance is satisfactory when project weaknesses are minor in nature and can be readily corrected within the existing project management framework. The institution's remediation progress to date meets or nearly meets expectations laid out in its Year 2000 project plan. Senior management and the board recognize and understand Year 2000 risk, are active in overseeing institutional corrective efforts, and have ensured that the necessary resources are available to address this risk area.

Needs Improvement: Year 2000 efforts of financial institutions and independent data centers are evaluated as “Needs Improvement” if they exhibit less than acceptable performance in all key phases of the Year 2000 project management process. Project weaknesses are evident, even if deficiencies are correctable within the existing project management framework. The institution's remediation progress to date is behind the schedule laid out in its Year 2000 project plan. Senior management or the board is not fully aware of the status of Year 2000 correction efforts, may not have committed sufficient financial or human resources to address this risk, or may not fully understand Year 2000 implications.

Unsatisfactory: Year 2000 efforts of financial institutions and independent data centers are considered “Unsatisfactory” if they exhibit poor performance in any of the key phases of the Year 2000 project management process. Project weaknesses are serious in nature and are not easily corrected within the existing project management framework. The institution's remediation progress is seriously behind the schedule laid out in its Year 2000 project plan. Senior management and the board do not understand or recognize the impact that the Year 2000 will have on the institution. Management or the board commitment is limited or their oversight activities are not evident.

Based on data updated through April 30, 1999, 10,159 institutions with \$6.4 trillion in assets have received a Satisfactory rating, 216 institutions with \$80 billion in assets a Needs Improvement rating, and 21 institutions with \$1 billion in assets an Unsatisfactory rating (data includes BIF- and SAIF-insured institutions). Although the initial results of the uniform reviews are encouraging, the Year 2000 issue is unprecedented. Therefore, it is difficult to determine which institutions, if any, will ultimately fail. Further, estimates of the cost of resolving Year 2000 failures are complicated by the uncertain nature of technological disruptions and the associated impact on the BIF, if any. Failures caused solely by liquidity problems would pose substantially less exposure to the BIF. Year 2000 failures could conceivably be such liquidity failures. The possibility that any such failure would occur is quite speculative in view of actions taken by the Federal Reserve Board to ensure sufficient liquidity and currency to meet the cash needs of insured banks.

Failures could occur because of the familiar capital insolvency (liabilities exceeding assets) if a substantial number of bank borrowers were unable to repay loans due to their own lack of preparedness for the Year 2000. Insured banks are required to be aware of the measures taken by key customers to protect themselves against adverse impact from the advent of Year 2000, and compliance with such requirements is monitored via the regulatory examination program. The extent to which insured institutions, if any, ultimately experience this type of failure is not measurable.

Financial institutions are required to design a Year 2000 contingency plan to mitigate the risks associated with the failure of systems at critical dates (Business Resumption Contingency Planning). A business resumption contingency plan is designed to provide assurance that core business functions will continue if one or more systems fail.

In order to assess the exposure to the BIF from Year 2000 potential failures, the FDIC evaluated all information relevant to such an assessment, to include Year 2000 on-site examination results, institution capital levels and supervisory examination composite ratings, and other institution past and current financial characteristics. As a result of this assessment, we conclude that, as of December 31, 1998, there are no probable losses to the BIF from Year 2000 failures. Further, any reasonably possible losses from Year 2000 failures were not estimable. During the remainder of 1999, the regulatory agencies will continue their Year 2000 reviews and the FDIC will continue to assess this potential liability.

Assistance Agreements

The estimated liabilities for assistance agreements resulted from several large transactions where problem assets were purchased by an acquiring institution under an agreement that calls for the FDIC to absorb credit losses and pay related costs for funding and asset administration, plus an incentive fee.

Litigation Losses

The BIF records an estimated loss for unresolved legal cases to the extent those losses are considered probable and reasonably estimable. In addition to the amount recorded as probable, the FDIC has determined that losses from unresolved legal cases totaling \$178 million are reasonably possible.

Asset Securitization Guarantees

As part of the FDIC's efforts to maximize the return from the sale or disposition of assets from bank resolutions, the FDIC has securitized some receivership assets. To facilitate the securitizations, the BIF provided limited guarantees to cover certain losses on the securitized assets up to a specified maximum. In exchange for backing the limited guarantees, the BIF received assets from the receiverships in an amount equal to the expected exposure under the guarantees. At December 31, 1998 and 1997, the BIF had an estimated liability under the guarantees of \$7 million and \$28 million, respectively. The maximum off-balance-sheet exposure under the limited guarantees is presented in Note 12.

8. Assessments

The 1990 OBR Act removed caps on assessment rate increases and authorized the FDIC to set assessment rates for BIF members semiannually, to be applied against a member's average assessment base. The FDICIA: 1) required the FDIC to implement a risk-based assessment system; 2) authorized the FDIC to increase assessment rates for BIF-member institutions as needed to ensure that funds are available to satisfy the BIF's obligations; 3) required the FDIC to build and maintain the reserves in the insurance funds to 1.25 percent of insured deposits; and 4) authorized the FDIC to increase assessment rates more frequently than semiannually and impose emergency special assessments as necessary to ensure that funds are available to repay U.S. Treasury borrowings. In May 1995, the BIF reached the FDICIA mandated capitalization level of 1.25 percent of insured deposits.

The DIFA (see Note 1) provided, among other things, for the elimination of the mandatory minimum assessment formerly provided for in the FDI Act. It also provided for the expansion of the assessment base for payments of the interest on obligations issued by the FICO to include all FDIC-insured institutions (including banks, thrifts, and Oakar and Sasser financial institutions). On January 1, 1997, BIF-insured banks began paying a FICO assessment. The FICO assessment rate on BIF-assessable deposits is one-fifth the rate for SAIF-assessable deposits. The annual FICO interest obligation of approximately \$790 million will be paid on a pro rata basis between

banks and thrifts on the earlier of January 1, 2000, or the date on which the last savings association ceases to exist.

The FICO assessment has no financial impact on the BIF. The FICO assessment is separate from the regular assessments and is imposed on banks and thrifts, not on the insurance funds. The FDIC, as administrator of the BIF and the SAIF, is acting solely as a collection agent for the FICO. During 1998 and 1997, \$341 million and \$338 million respectively, were collected from banks and remitted to the FICO.

The FDIC uses a risk-based assessment system that charges higher rates to those institutions that pose greater risks to the BIF. To arrive at a risk-based assessment for a particular institution, the FDIC places each institution in one of nine risk categories, using a two-step process based first on capital ratios and then on other relevant information. The Board reviews premium rates semiannually. The assessment rate averaged approximately 0.08 cents per \$100 of assessable deposits for 1998 and 1997. On October 27, 1998, the Board voted to retain the BIF assessment schedule of 0 to 27 cents per \$100 of assessable deposits (annual rates) for the first semiannual period of 1999.

9. Provision for Insurance Losses

Provision for insurance losses was a negative \$38 million and a negative \$495 million for 1998 and 1997, respectively. In 1998 and 1997, the negative provision resulted primarily from decreased

losses expected for assets in liquidation. The following chart lists the major components of the negative provision for insurance losses.

Provision for Insurance Losses

Dollars in Thousands

	For the Year Ended December 31, 1998	For the Year Ended December 31, 1997
Valuation adjustments:		
Open bank assistance	\$ (2,431)	\$ (12,180)
Closed banks	(53,926)	(356,347)
Assets acquired from assisted banks and terminated receiverships	2,222	(47,245)
Total	(54,135)	(415,772)
Contingencies:		
Anticipated failure of insured institutions	29,000	(59,000)
Assistance agreements	(8,322)	(12,716)
Asset securitization guarantees	(13,043)	(6,558)
Litigation	8,801	(1,250)
Total	16,436	(79,524)
Reduction in Provision for Insurance Losses	\$ (37,699)	\$ (495,296)

10. Pension Benefits, Savings Plans, and Accrued Annual Leave

Eligible FDIC employees (all permanent and temporary employees with appointments exceeding one year) are covered by either the Civil Service Retirement System (CSRS) or the Federal Employee Retirement System (FERS). The CSRS is a defined benefit plan, which is offset with the Social Security System in certain cases. Plan benefits are determined on the basis of years of creditable service and compensation levels. The CSRS-covered employees also can contribute to the tax-deferred Federal Thrift Savings Plan (TSP).

The FERS is a three-part plan consisting of a basic defined benefit plan that provides benefits based on years of creditable service and compensation levels, Social Security benefits, and the TSP. Automatic and matching employer contributions to the TSP are provided up to specified amounts under the FERS.

During 1998, there was an open season that allowed employees to switch from CSRS to FERS. This did not have a material impact on BIF's operating expenses.

Although the BIF contributes a portion of pension benefits for eligible employees, it does not account for the assets of either retirement system. The BIF also does not have actuarial data for accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported on and accounted for by the U.S. Office of Personnel Management (OPM).

Eligible FDIC employees also may participate in a FDIC-sponsored tax-deferred savings plan with matching contributions. The BIF pays its share of the employer's portion of all related costs.

The BIF's pro rata share of the Corporation's liability to employees for accrued annual leave is approximately \$38.4 million and \$35.7 million at December 31, 1998 and 1997, respectively.

Pension Benefits and Savings Plans Expenses

Dollars in Thousands

	For the Year Ended December 31, 1998	For the Year Ended December 31, 1997
CSRS/FERS Disability Fund	\$ 1,166	\$ 488
Civil Service Retirement System	10,477	8,708
Federal Employee Retirement System (Basic Benefit)	27,857	28,661
FDIC Savings Plan	17,534	16,974
Federal Thrift Savings Plan	10,991	10,568
Total	\$ 68,025	\$ 65,399

11. Postretirement Benefits Other than Pensions

On January 2, 1998, BIF's obligation under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," for postretirement health benefits was reduced when over 6,500 employees enrolled in the Federal Employees Health Benefits (FEHB) Program for their future health insurance coverage. The OPM assumed the BIF's obligation for postretirement health benefits for these employees at no initial enrollment cost.

In addition, legislation was passed that allowed the remaining 2,600 retirees and near-retirees (employees within five years of retirement) in the FDIC health plan to also enroll in the FEHB

Program for their future health insurance coverage, beginning January 1, 1999. The OPM assumed the BIF's obligation for postretirement health benefits for retirees and near-retirees for a fee of \$150 million. The OPM is now responsible for postretirement health benefits for all employees and covered retirees. The FDIC will continue to be obligated for dental and life insurance coverage for as long as the programs are offered and coverage is extended to retirees.

OPM's assumption of the health care obligation constitutes both a settlement and a curtailment as defined by SFAS No. 106. This conversion resulted in a gain of \$201 million to the BIF.

Postretirement Benefits Other Than Pensions

Dollars in Thousands

	1998	1997
Funded Status at December 31		
Fair value of plan assets ^(a)	\$ 67,539	\$ 356,447
Less: Benefit obligation	67,539	378,227
Under/(Over) Funded Status of the plans	\$ 0	\$ 21,780
Accrued benefit liability recognized in the Statements of Financial Position	\$ 0	\$ 39,231

Expenses and Cash Flows for the Period Ended December 31

Net periodic benefit cost	\$ (1,942)	\$ 3,305
Employer contributions	6,229	4,604
Benefits paid	6,229	4,604

Weighted-Average Assumptions at December 31

Discount rate	4.50%	5.75%
Expected return on plan assets	4.50%	5.75%
Rate of compensation increase	4.00%	5.75%

(a) Invested in U.S. Treasury obligations.

For measurement purposes, the per capita cost of covered health care benefits was assumed to increase by an annual rate of 8.75 percent for 1998. Further, the rate was assumed to decrease

gradually each year to a rate of 7.75 percent for the year 2000 and remain at that level thereafter.

12. Commitments and Off-Balance-Sheet Exposure

Commitments

Leases

The BIF's allocated share of the FDIC's lease commitments totals \$177.2 million for future years. The lease agreements contain escalation clauses resulting in adjustments, usually on an annual basis. The allocation to the BIF of the FDIC's future lease

commitments is based upon current relationships of the workloads among the BIF, the FRF, and the SAIF. Changes in the relative workloads could cause the amounts allocated to the BIF in the future to vary from the amounts shown below. The BIF recognized leased space expense of \$47.7 million and \$43.6 million for the years ended December 31, 1998 and 1997, respectively.

Lease Commitments

Dollars in Thousands

1999	2000	2001	2002	2003	2004 and Thereafter
\$39,287	\$34,699	\$27,905	\$24,423	\$15,096	\$35,765

Asset Securitization Guarantees

As discussed in Note 7, the BIF provided certain limited guarantees to facilitate securitization transactions. The table below gives the

maximum off-balance-sheet exposure the BIF has under these guarantees.

Asset Securitization Guarantees

Dollars in Thousands

	December 31, 1998	December 31, 1997
Maximum exposure under the limited guarantees	\$ 481,313	\$ 481,313
Less: Guarantee claims paid (inception-to-date)	(27,253)	(19,231)
Less: Amount of exposure recognized as an estimated liability (see Note 7)	(7,141)	(27,715)
Maximum Off-Balance-Sheet Exposure Under the Limited Guarantees	\$ 446,919	\$ 434,367

Concentration of Credit Risk

As of December 31, 1998, the BIF had \$18.8 billion in gross receivables from bank resolutions and \$170 million in assets acquired from assisted banks and terminated receiverships. An allowance for loss of \$18 billion and \$142 million, respectively, has been

recorded against these assets. The liquidating entities' ability to make repayments to the BIF is largely influenced by the economy of the area in which they are located. The BIF's maximum exposure to possible accounting loss for these assets is shown in the table below.

Concentration of Credit Risk at December 31, 1998

Dollars in Millions

	Southeast	Southwest	Northeast	Midwest	Central	West	Total
Receivables from bank resolutions, net	\$ 9	\$ 35	\$ 575	\$ 11	\$ 2	\$ 116	\$ 748
Assets acquired from assisted banks and terminated receiverships, net	0	21	5	0	0	1	27
Total	\$ 9	\$ 56	\$ 580	\$ 11	\$ 2	\$ 117	\$ 775

Other Off-Balance-Sheet Risk

Deposit Insurance

As of December 31, 1998, deposits insured by the BIF totaled approximately \$2.1 trillion. This would be the accounting loss if all depository institutions were to fail and the acquired assets provided no recoveries.

13. Disclosures About the Fair Value of Financial Instruments

Cash equivalents are short-term, highly liquid investments and are shown at current value. The fair market value of the investment in U.S. Treasury obligations is disclosed in Note 3 and is based on current market prices. The carrying amount of interest receivable on investments, short-term receivables, and accounts payable and other liabilities approximates their fair market value. This is due to their short maturities or comparisons with current interest rates.

The net receivables from bank resolutions primarily include the BIF's subrogated claim arising from payments to insured depositors. The receivership assets that will ultimately be used to pay the corporate subrogated claim are valued using discount rates that include consideration of market risk. These discounts ultimately affect the BIF's allowance for loss against the net receivables from bank resolutions. Therefore, the corporate subrogated claim indirectly includes the effect of discounting and should not be viewed as being stated in terms of nominal cash flows.

Although the value of the corporate subrogated claim is influenced by valuation of receivership assets (see Note 4), such receivership valuation is not equivalent to the valuation of the corporate claim. Since the corporate claim is unique, not intended for sale to the private sector, and has no established market, it is not practicable to estimate its fair market value.

The FDIC believes that a sale to the private sector of the corporate claim would require indeterminate, but substantial discounts for an interested party to profit from these assets because of credit and other risks. In addition, the timing of receivership payments to the BIF on the subrogated claim does not necessarily correspond with the timing of collections on receivership assets. Therefore, the effect of discounting used by receiverships should not necessarily be viewed as producing an estimate of market value for the net receivables from bank resolutions.

The majority of the net assets acquired from assisted banks and terminated receiverships (except real estate) is comprised of various types of financial instruments, including investments, loans and accounts receivables. Like receivership assets, assets acquired from assisted banks and terminated receiverships are valued using discount rates that include consideration of market risk. However, assets acquired from assisted banks and terminated receiverships do not involve the unique aspects of the corporate subrogated claim, and therefore the discounting can be viewed as producing a reasonable estimate of fair market value.

14. Supplementary Information Relating to the Statements of Cash Flows

Reconciliation of Net Income to Net Cash Provided by Operating Activities

Dollars in Thousands

	For the Year Ended December 31, 1998	For the Year Ended December 31, 1997
Net Income	\$ 1,308,723	\$ 1,438,293
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Income Statement Items:		
Provision for insurance losses	(37,699)	(495,296)
Amortization of U.S. Treasury obligations	133,705	60,261
Gain on sale of investments	(224)	0
Gain on conversion of benefit plan	(200,532)	0
Depreciation on property and equipment	3,745	3,339
Change in Assets and Liabilities:		
(Increase) in interest receivable on investments and other assets	(39,983)	(87,996)
Decrease in receivables from bank resolutions	417,444	3,600,647
Decrease in assets acquired from assisted banks and terminated receiverships	31,129	60,693
Increase (Decrease) in accounts payable and other liabilities	6,534	(21,997)
(Decrease) in estimated liabilities for anticipated failure of insured institutions	(8,000)	(5,000)
(Decrease) in estimated liabilities for assistance agreements	(8,505)	(6,147)
(Decrease) in estimated liabilities for asset securitization guarantees	(7,531)	(10,007)
Net Cash Provided by Operating Activities	\$ 1,598,806	\$ 4,536,790

15. Year 2000 Issues

State of Readiness

The FDIC, as administrator for the BIF, is conducting a corporate-wide effort to ensure that all FDIC information systems are Year 2000 compliant. This means the systems must accurately process date and time data in calculations, comparisons, and sequences after December 31, 1999, and be able to correctly deal with leap-year calculations in 2000. The Year 2000 Oversight Committee is comprised of FDIC division management that oversees the Year 2000 effort.

The FDIC's Division of Information Resources Management (DIRM) leads the internal Year 2000 effort, under the direction of the Oversight Committee. DIRM used a five-phase approach for ensuring that all FDIC systems and software are Year 2000 compliant. The five phases are:

Awareness

The first phase of compliance focuses on defining the Year 2000 problem and gaining executive-level support and sponsorship for the effort.

Assessment

The second phase of compliance focuses on assessing the Year 2000 impact on the Corporation as a whole.

Renovation

The third phase of compliance focuses on converting, replacing or eliminating selected platforms, applications, databases, and utilities, while modifying interfaces as appropriate.

Platform is a broad term that encompasses computer hardware (including mainframe computers, servers, and personal computers) and software (including computer languages and operating systems). Utility programs, or "utilities," provide file management capabilities, such as sorting, copying, comparing, listing and searching, as well as diagnostic and measurement routines that check the health and performance of the system.

Validation

The fourth phase of compliance focuses on testing, verifying and validating converted or replaced platforms, applications, databases, and utilities.

Implementation

The fifth phase of compliance focuses on implementing converted or replaced platforms, applications, databases, utilities, and interfaces.

The Awareness, Assessment, and Renovation phases are complete. The Validation phase is scheduled to be completed during January 1999 when all production applications will be validated for Year 2000 readiness. Implementation of the majority of production applications in Year 2000 ready status will be completed by March 31, 1999. Validation and implementation of new systems and modifications to existing systems will continue throughout 1999.

Year 2000 Estimated Costs

Year 2000 compliance expenses for the BIF are estimated at \$34.7 million and \$1.6 million at December 31, 1998 and 1997, respectively. These expenses are reflected in the "Operating expenses" line item of the BIF's Statements of Income and Fund Balance. Future expenses are estimated to be \$49 million. Year 2000 estimated future costs are included in the FDIC's budget.

Risks of Year 2000 Issues

The FDIC's Division of Supervision has an ongoing aggressive initiative to assess the BIF's supervised financial institutions for Year 2000 compliance. Other BIF-insured institutions are being assessed by their respective regulatory agencies. The BIF is subject to a potential loss from financial institutions that may fail as a result of Year 2000 related issues. Refer to "Estimated Liabilities for: Anticipated Failure of Insured Institutions - Year 2000 Anticipated Failures" (Note 7) for additional information.

No potential loss with internal system failure has been estimated due to the extensive planning and validation that has occurred.

Contingency Plans

DIRM is currently developing a disaster recovery plan and contingency plans specific to each mission-critical application.

Other divisions within the FDIC are working together to develop contingency plans to be prepared if any FDIC-insured financial institution fails as a result of lack of Year 2000 preparedness.